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R. J. Reynolds Tobacco Company

Winston-Salem, N.C.

ANNUAL REPORT

1946

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R J Reynolds
Tobacco Company

Summary of Financial Data for 1946

Sales and Earnings

Net Sales	$613,106,303
Profit before Taxes on Income	$ 49,309,249
Federal and State Taxes on Income	$ 21,336,650
Net Earnings	$ 27,972,599
Net Earnings as a percentage of Net Sales	4.56%
Net Earnings per share of Preferred Stock	$ 57.08
Net Earnings per share of Common Stocks after Preferred Stock dividends	$ 2.62

Disposition of Net Earnings

Dividends paid on 490,000 shares of Preferred Stock, 3.60% Series, totalling $3.60 a share	$ 1,764,000
Dividends paid on 10,000,000 shares of Common Stocks, totalling $1.75 a share	$ 17,500,000
Amount of Net Earnings retained for additional working capital, debt reduction and other purposes	$ 8,708,599

Balance Sheet Items

Total Assets	$390,182,316
Current Assets ($368,378,678) less Current Liabilities ($105,061,116)—Working Capital	$263,317,562
Funded Debt	$ 64,000,000
Capital Stock	$149,000,000
Surplus—Undivided Profits	$ 72,121,200

R. J. REYNOLDS TOBACCO COMPANY
Winston-Salem, North Carolina

TO THE STOCKHOLDERS:

The year 1946, for which report of the Company's operations is herewith presented, witnessed a continued substantial expansion of the Company's business and was marked by definite movements in the direction of the re-establishment of normal conditions of operation. During April 1946, the O. P. A. allowed a limited price increase on cigarettes, following some earlier increases on other products, thus ameliorating the situation in the industry created largely by continued increases in the cost of leaf tobaccos—a situation which bore particularly hard on this Company as a maker of high-quality products and, therefore, necessarily a user of high-cost leaf. Later in the year, Government abandoned all price controls on tobacco products and also eliminated price ceilings on leaf tobaccos and allocations of the amount thereof that could be purchased by respective manufacturers—two other controls which had substantially limited Company operations during the war years.

Net Earnings and Sales

The Company's operations in 1946 resulted in net earnings of $27,972,599 as against the $19,229,310 earned in 1945, exclusive of the excess profits tax carry-back credit for 1945 in the amount of $467,545. The 1946 net earnings available for the common stocks after deducting dividends on the Preferred Stock were $2.62 per share in comparison with $1.84 per share for 1945. Dividends paid in 1946 on the common stocks consisted of four quarterly dividends of 35 cents each and a year-end dividend in the same amount, totalling $1.75 per share as against $1.60 per share paid in 1945.

Net sales of the Company in 1946 aggregated $613,106,303 and were $182,139,737 in excess of the $430,966,566 net sales in 1945. Of the increase in dollar sales, approximately one-third was accounted for by a shift in sales made on a tax-free basis in 1945 to a tax-paid basis in 1946 and by price increases made effective during 1946.

In 1946 sales of CAMEL Cigarettes again established a new high mark, the number sold being substantially greater than in 1945 when the previous high mark was established. In accordance with traditional experience under similar circumstances, the heavy increase in 1946 in sales of cigarettes for domestic consumption was accompanied by a considerable decrease in the number of pounds of smoking tobaccos sold in that year as against such sales in the preceding year. The Company's sales of chewing tobacco, in pounds, were but slightly less in 1946 than in 1945.

On April 29, 1946, promptly after O. P. A. granted permission therefor, the price of CAMEL Cigarettes was increased by 28 cents per thousand less the usual discounts of 10% and 2%. This was the first price increase on CAMEL Cigarettes permitted by Government during the period of its control of maximum prices for cigarettes and, in fact, the first increase in the price of CAMELS since 1937, except for the two adjustments made on account of increases in Federal excise taxes on cigarettes and made in amounts slightly less than sufficient to cover such increases. In view of the insufficiency of the price increase permitted in April and after removal by Government of ceiling prices on cigarettes, the price of CAMELS was further advanced on October 14, 1946 by 26 cents per thousand less the usual discounts. During the year, price increases also were made on other products of the Company.

Inventories and Net Working Capital

The Company's inventories at the end of 1946, consisting predominantly of leaf tobaccos, amounted to $334,675,764 compared with $265,022,008 at the end of 1945. The increase in inventories is due to the purchase of increased quantities of leaf tobaccos necessary to take care of the Company's expanding business and to the considerably higher prices paid for leaf tobaccos in 1946. The amount of the inventory for 1946 is stated, as in previous years, in terms of the net inventory after deduction of the reserve for contingent carrying charges. In accordance with the long-established custom of the Company and of the tobacco industry generally, leaf tobaccos are carried for inventory purposes on the average cost method, under which each purchase of tobacco from any crop is averaged in, grade by grade, with like tobaccos on hand thereby establishing an average cost for each grade.

At the end of 1946, the current assets of the Company exceeded its current liabilities by $263,317,562 compared with a net working capital of $199,695,064 at the end of 1945. This increase was largely accounted for by the $60,000,000 long-term loan obtained during the year.

New Borrowing Arrangements

During the past year the Company's stand-by credit agreement entered into in 1942 with twelve banks and amended in 1944 to increase the credit available to $100,000,000 was replaced by a new stand-by credit agreement with fourteen of the Company's depositary banks, including the twelve banks in the earlier agreement. Under the new agreement a credit aggregating $150,000,000 is available to the Company throughout the five-year period until June 30, 1951. Borrowings under the credit are made against short-term notes of the Company, such notes being discounted by the respective lending banks at the prime commercial discount rate of each such bank but not to exceed 1¾% per annum. Borrowings made under the new credit in 1946 were at the rate of 1½% per annum.

Inasmuch as the requirements of the Company's expanding business, further emphasized by the recent and present high cost of leaf tobaccos, indicate an advantageous use of a substantial amount of borrowed funds for a number of years in the future, and in view of the low interest rate and other favorable features available through such a long-term loan, the Company in October 1946 sold at par its $60,000,000 note to an insurance company, the note bearing interest at 2½% per annum and being payable in installments of $3,000,000 during each of the years 1950 to 1957, inclusive, and of $4,000,000 during each of the years 1958 to 1966, inclusive.

Employees' Retirement Plan

On December 17, 1946 stockholders of the Company adopted an Employees' Retirement Plan to become effective as of January 1, 1946. The retirement plan for employees of the Company which had been in operation since 1929 was discontinued as of December 31, 1946, but all retired employees then entitled to benefits under that plan will continue to receive such benefits in accordance with the provisions of the 1929 plan.

The adoption of the new plan and the discontinuance of the 1929 plan culminated an extensive study of the Company's old plan and of the values of using a retirement plan in the proper and effective administration of the affairs of the Company and determination of the type and specific provisions of a plan calculated to serve best the needs of the Company. It was found that while the current costs of the 1929 plan were not unreasonable the much higher level of pay rates that had developed in recent years and the constantly increasing number of employees becoming eligible for retirement would, in a short period of years, make the cost of that plan excessive. Since, too, the 1929 plan, which was adopted several years prior to the Federal Social Security Law, provided benefits that were not adjusted

to or integrated with the old-age benefits under such Law, adherence to that plan would have involved acceptance of the inequity and excessive burden of partial double payment of benefits on that part of each employee's compensation not in excess of $3,000. It was also found that the 1929 plan with its low limitation on retirement payments to employees in higher compensation brackets did not lend itself to the important use of maintaining in the soundest and most economical way incentives for employees in the groups affected more burdensomely by the high individual income tax rates that have developed since adoption of the 1929 plan.

The new plan, while eliminating difficulties and inequities of the old plan and incorporating additional features valuable in the administration of the Company's business, serves the important objective of placing the whole retirement program on a sound, secure basis. Annual contributions, which will serve to distribute the cost of the plan evenly over the years, are being made by the Company into a trust fund to be used to pay retirement allowances. These contributions are actuarially calculated as sufficient, with the income earned on the trust fund, to pay the retirement allowances provided by the plan.

In 1946, the Company contributed to the new plan $2,285,436, including $1,170,618 on account of benefits for service prior to 1946—a contribution which, when deducted in computing the Company's Federal income tax liability, will represent a net cost of not more than 62% of the amount of the contribution. It is estimated that the cost of prior service benefits will be fully funded over an additional period of about 10½ years by payment of similar amounts of prior service cost for each of the years during that period.

Number of Stockholders

As of the latest dates on which reviews were made in 1946, there were 62,775 holders of the Company's Common and New Class B Common Stocks and 8,674 holders of the Company's Preferred Stock. Of the holders of the common stocks, 30,254 were women, 21,992 were men and 10,529 were trustees, institutions, firms, etc. The Preferred Stock was held by 3,698 women, 2,983 men and 1,993 trustees, institutions, firms, etc.

Allocation of Cigarette Sales

When during the war restrictions imposed by Government prevented the Company from purchasing in full its anticipated requirements of leaf tobaccos, the Company, under the shortage of leaf tobaccos thus enforced upon it, was confronted with the necessity of refraining from expanding the production of CAMEL Cigarettes commensurately with the greatly increased demand therefor or, in the alternative, of making CAMELS out of tobaccos not sufficiently matured to insure continuation of the traditional high quality of the brand. Accordingly, decision was made in 1943 to limit the production of CAMELS to the quantity for which properly aged tobaccos were available. That necessitated distribution to customers, other than Government purchasing for members of the Armed Forces, through a uniform percentage allocation against base period purchases. As the more liberal purchases which Government permitted the Company to make from crops in the later war years have matured for manufacture, it has been possible continuously to expand the manufacture of CAMELS, but they are still under allocation. However, the enlarged purchases which Government permitted the Company to make from recent crops and the fact that no restrictions were applied with respect to purchases from the 1946 crop mean that when tobaccos now in the inventory are sufficiently matured for manufacture the Company will again be in position to manufacture CAMELS in sufficient quantity to meet the demand as now anticipated.

J. W. GLENN,
President.

January 21, 1947.

R. J. REYNOLDS TO
Balance Sheet, De

ASSETS

CURRENT ASSETS:		
Cash	$ 15,885,681.21	
Accounts receivable (net) for merchandise sold	17,212,269.73	
Carry-back credit on excess profits tax	604,962.74	
Leaf tobacco, supplies, manufactured product, etc.—at average cost	334,675,764.30	
TOTAL CURRENT ASSETS		$368,378,677.98
REAL ESTATE, MACHINERY AND EQUIPMENT—at cost	$ 35,488,271.26	
Less depreciation, obsolescence, etc.	16,651,568.95	
NET REAL ESTATE, MACHINERY AND EQUIPMENT		18,836,702.31
OTHER ASSETS:		
Investments in non-competitive companies	$ 25,000.00	
Sundry receivables and deposits	1,269,294.54	
Brands, trade-marks and good will	1.00	
Prepaid expenses	668,478.04	
Retirement and Insurance Investment Fund (consisting of 200,000 shares of Common Stock of the Company)	$ 10,120,000.00	
Less reserve accrued to December 31, 1946	9,115,837.72	
	1,004,162.28	
TOTAL OTHER ASSETS		2,966,935.86
		$390,182,316.15

)BACCO COMPANY
ecember 31, 1946

LIABILITIES

CURRENT LIABILITIES:		
Accounts payable	$ 4,640,643.55	
Notes payable	75,000,000.00	
Serial notes payable in 1947	2,000,000.00	
Accrued Federal and State taxes	22,574,833.53	
Sundry accrued accounts	345,638.97	
Reserve for contingencies	500,000.00	
TOTAL CURRENT LIABILITIES		$105,061,116.05
FUNDED DEBT:		
Serial notes (1¾%) payable 1948-1949	$ 4,000,000.00	
2½% Promissory Note payable 1950-1966	60,000,000.00	
TOTAL FUNDED DEBT		64,000,000.00
CAPITAL AND SURPLUS:		
Preferred Stock—Par $100:		
Authorized 750,000 shares		
Issued 490,000 shares—		
3.60% Series	$ 49,000,000.00	
Common Stock—Par $10:		
Authorized 1,000,000 shares		
Issued 1,000,000 shares	10,000,000.00	
New Class B Common Stock—Par $10:		
Authorized 13,000,000 shares		
Issued 9,000,000 shares	90,000,000.00	
	$149,000,000.00	
Surplus—Undivided Profits (Note A)	72,121,200.10	
TOTAL CAPITAL AND SURPLUS		221,121,200.10
		$390,182,316.15

Statement of Income

Year Ended December 31, 1946

NET SALES		$613,106,303.61
OTHER INCOME:		
Profit on securities sold	$ 242,716.14	
Dividends, interest and sundry	18,068.25	260,784.39
TOTAL INCOME		$613,367,088.00
LESS:		
Cost of goods sold and other charges, including selling and general expenses, but exclusive of items below	$559,590,184.69	
Provision for depreciation and obsolescence	958,318.62	
Interest charges	1,624,223.46	
Provision for participation in profits under Article XII of By-Laws payable to 1,730 officers and employees	1,885,112.20	
TOTAL INCOME DEDUCTIONS		564,057,838.97
PROFIT BEFORE TAXES ON INCOME		$ 49,309,249.03
Less—Provision for Federal and State taxes on income		21,336,650.02
NET EARNINGS FOR YEAR		$ 27,972,599.01
Dividends paid on Preferred Stock		$ 1,764,000.00
NET EARNINGS APPLICABLE TO COMMON STOCKS		$ 26,208,599.01

Statement of Surplus

Year Ended December 31, 1946

SURPLUS—UNDIVIDED PROFITS at beginning of year		$ 63,412,601.09
ADD:		
Net earnings for year		27,972,599.01
		$ 91,385,200.10
DEDUCT:		
Cash dividends on—		
Preferred Stock, 3.60% Series	$ 1,764,000.00	
Common stocks (including 200,000 shares of Common Stock held in Retirement and Insurance Investment Fund), consisting of four quarterly dividends of 35c each and a year-end dividend of 35c a share	17,500,000.00	
		19,264,000.00
SURPLUS—UNDIVIDED PROFITS at end of year (Note A)		$ 72,121,200.10

F. S. HILL, Treasurer.

Note A: So long as its 2½% Promissory Note or any part thereof remains unpaid the Company is obligated not to declare dividends (other than stock dividends) and not to make payment on account of purchase, redemption or retirement of any shares of its stock to an extent where such dividend or payment plus the aggregate of all such prior dividends and payments made from January 1, 1946 shall exceed an amount equal to the Net Income of the Company from January 1, 1946 to and including the date of such declaration or payment plus $15,000,000, but such limitation does not restrict declaration or payment of dividends on Preferred Stock.

Report of Independent Certified Public Accountants

R. J. REYNOLDS TOBACCO COMPANY:

We have examined the balance sheet of R. J. REYNOLDS TOBACCO COMPANY as at December 31, 1946, and the statements of income and surplus for the year then ended, have reviewed the system of internal control and the accounting procedures of the Company and, without making a detailed audit of the transactions, have examined or tested accounting records of the Company and other supporting evidence, by methods, at times and to the extent we deemed appropriate. Our examination was made in accordance with generally accepted auditing standards applicable in the circumstances and included all procedures which we considered necessary. We were present when inventories were taken by the Company and checked procedures followed in determining quantities and valuation.

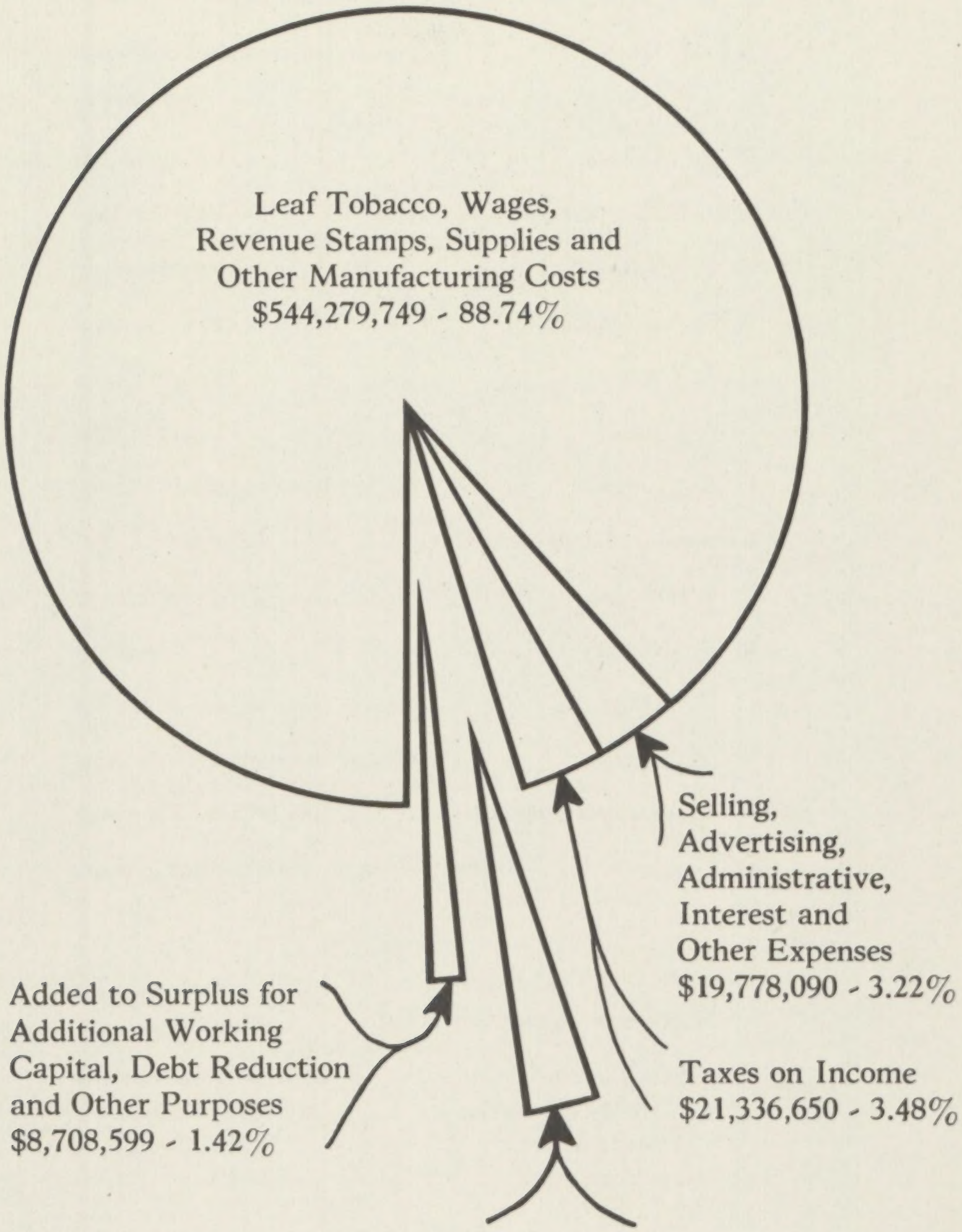
In our opinion, the accompanying balance sheet and related statements of income and surplus present fairly the position of the Company at December 31, 1946, and the results of its operations for the year, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

ERNST & ERNST,

Certified Public Accountants.

January 20, 1947.

Disposition of the Company's Total Income in 1946



Board of Directors

S. Clay Williams	*Chairman Board of Directors*
Jas. A. Gray	*Chairman Executive Committee*
J. W. Glenn	*President*
R. E. Lasater	*Vice-President*
John C. Whitaker	*Vice-President*
R. C. Haberkern	*Vice-President*
P. Frank Hanes	*Vice-President*
E. A. Darr	*Vice-President*
L. F. Owen	*Traffic Manager*
H. S. Stokes	*Superintendent Leaf Processing*
Richard J. Reynolds	*(Absent on Leave)*
F. S. Hill	*Treasurer*
W. J. Conrad, Jr.	*Secretary*
H. N. Hardy	*General Leaf Supervisor*
W. T. Smither	*Manager Advertising Department*
R. G. Vallandingham	*General Leaf Supervisor*
H. H. Ramm	*Solicitor and Assistant to Chairman of Board*

Transfer Agent

The Chase National Bank
of the City of New York,
11 Broad Street,
New York, N. Y.

Registrar

Central Hanover Bank
and Trust Company,
70 Broadway,
New York, N. Y.

Principal Brands of the Company

CAMEL
CIGARETTES

Smoking Tobaccos

PRINCE ALBERT

GEORGE WASHINGTON • OUR ADVERTISER

STUD • TOP

Chewing Tobaccos

BROWN'S MULE • DAY'S WORK

APPLE SUN CURED

REYNOLDS' NATURAL LEAF

REYNOLDS' SUN CURED

CUP • SCHNAPPS • HONEY CUT

STRATER'S NAT. LEAF TWIST

WINESAP • MICKY TWIST

TOP